SUPREME COURT, U. S.
FILED

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-810

CARR STALEY, INC., *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*.

BRIEF FOR THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AMICUS CURIAE

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QUESTION PRESENTED

Whether Section 636(b) of the Internal Revenue Code is unconstitutional as a denial of due process on the grounds that it represents an attempt by Congress to tax the income from property owned by another person to petitioner.

CONSTITUTIONAL PROVISION INVOLVED

Constitution of the United States, Amendment V:

> "No person shall . . . be deprived of life, liberty, or property, without due process of law . . . ."

STATUTE INVOLVED

Internal Revenue Code of 1969 (26 U.S.C.):

> SEC. 636. INCOME TAX TREATMENT OF MINERAL PRODUCTION PAYMENTS.
>
> (b) Retained Production Payment on Sale of Mineral Property.—A production payment retained on the sale of a mineral property shall be treated, for purposes of this subtitle, as if it were a purchase money mortgage loan and shall not qualify as an economic interest in the mineral property.

INTEREST OF AMICUS CURIAE

The Independent Petroleum Association of America as Amicus Curiae respectfully tenders this brief on behalf of the position of petitioner Carr Staley, Inc. requesting this Court to grant petitioner's writ of certiorari to the United States Court of Appeals for the Fifth Circuit.

The Amicus Curiae is an association representing some 4,000[1] independent oil and gas producers in virtually every producing area in the United States. These oil and gas producers have an interest in the outcome of the instant case as follows:

(a) The issue before the Court concerns the constitutionality of section 636(b) of the Revenue Act of 1969; and

(b) That section of the Code provides that the buyer of an oil lease, where the seller has reserved a

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[1] Although the Amicus Curiae has 4,000 members, the latest figures reported by the Federal Energy Agency show that there are approximately 18,000 independent oil and gas producers in the United States.

production payment, must report the income from said reserved production payment received by the seller over the life of the production payment, notwithstanding the following: (1) the buyer does not have legal title to the production payment, (2) the buyer never receives the production payment proceeds, (3) the buyer has not executed or delivered a promissory note or mortgage to the seller, (4) the buyer has no legal right to receive any part of the production proceeds and (5) the buyer has no control over either the producing property or the disposition of the income therefrom.

For the foregoing reasons, your Amicus Curiae has a definite interest in the outcome of this case since section 636(b) requires independent oil and gas producers to pay tax on income received by another person, all of which is discriminatory and in violation of the due process clause of the Fifth Amendment.

STATEMENT OF THE CASE

Your Amicus Curiae adopts the statement of facts as set forth on pages 2, 3 and 4 of petitioner Carr Staley, Inc.'s Petition For Writ Of Certiorari.

ARGUMENT

Certiorari Should Be Granted Because the Constitutional Question Presented Herein Affects the Entire Oil and Gas Industry Which Question Has Not Been, But Should Be, Settled by This Court.

Your Amicus Curiae is in complete agreement with the "Reasons For Granting The Writ" as set forth in

petitioner Carr Staley, Inc.'s Petition for Writ of Certiorari.

In addition thereto, your Amicus Curiae sets forth the following arguments:

(a) If Congress has the power to tax retained production payment income to the working interest owner, then it has the power to tax (1) royalty income to the working interest owner, (2) overriding royalty income to the working interest owner and (3) net profits interest income to the working interest owner. This is a real threat to the entire oil and gas industry. In each instance the working interest owner has absolutely no rights of ownership in the retained production payment, royalty, overriding royalty and net profits interest. In most instances there is no economic distinction between a retained production payment situation and a retained overriding royalty situation. The reason is very simple. No one knows for sure the life of an oil property. At most it is an educated guess. For example, a petroleum engineer may render his opinion that a certain retained production payment will pay out in seven years and that the mineral property will produce for ten years. Based upon that opinion, the tax law provides that the retained interest is a production payment. But in many instances, the petroleum engineer is wrong (it is humanly impossible for an engineer to know the exact amount of oil and gas which can be produced from any certain formation); the production payment does not pay out in seven years and in fact it has not paid out when the lease has reached its economic limit and is abandoned; then the "so called" production payment is not a limited interest and for economic purposes it has become an overriding royalty (since it has extended over the entire

life of the property). Yet, under section 636(b), the owner of the working interest is required to pay tax upon the proceeds of the so called "retained production payment" received by another person. Under those facts, the buyer-owner of the working interest has paid a tax on another's income and has no legal rights of any kind against such other person.

Sales with reserved production payments are everyday transactions in the oil and gas industry. To require the buyers of such oil and gas leases to report the income received by the seller on his retained production is discriminatory, arbitrary, capricious and represents a taking of property without due process of law. *Hoeper* v. *Tax Commission of Wisconsin*, 284 U.S. 206 (1931). Your Amicus Curiae submits that if section 636(b) is constitutional, then Congress has the power to enact legislation taxing to the working interest owner the income received by the royalty owner, overriding royalty owner and net profits interest owner. Such power would render the due process clause of the Fifth Amendment meaningless.

(b) Section 636(b) provides that "a production payment retained on the sale of a mineral property shall be treated *as if it were a purchase money mortgage loan.*" Herein, Congress has created a fiction which does not conform with reality. Congress has attempted to create a mortgage-debt situation when, in fact, no such situation exists. The taxpayer has no liability to Guinn, the owner of the retained production payment, and conversely, Guinn has no legal rights against taxpayer. The absurdity of the statute is further evidenced by the fact that Guinn has an absolute right to mortgage his retained production payment free and clear of any rights or interest of the taxpayer.

It is clear that Congress has enacted a statute which has no bearing or relationship to the realities of a transaction involving a retained production payment.

If Congress has the power to tax one person upon the income of property owned by another person by merely using the phrase "shall be treated as if it were" in this instance, then it has the power to tax the income from any other property interests to another person by using the same language. It follows then that such language creates a conclusive presumption by denying to the taxpayer the right to a fair opportunity to rebut the issue of whether or not a sale with a purchase money mortgage was made by the parties. *Heiner* v. *Donnan* 285 U.S. 312 (1932) and *Schlesinger* v. *Wisconsin* 270 U.S. 230 (1926).

CONCLUSION

The Petition for Writ of Certiorari filed by petitioner Carr Staley Inc. should be granted since the question presented is an important constitutional question affecting the entire oil and gas industry and which question has not been, but should be, settled by this Court.

Respectfully submitted,

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